FILED
NOV 8 1926

No. 304

In the Supreme Court of the United States

OCTOBER TERM, 1925

WILLIAM H. EDWARDS, AS COLLECTOR OF INTERNAL REVENUE FOR THE SECOND DISTRICT OF NEW YORK, PETITIONER

v.

NEW YORK LIFE INSURANCE COMPANY

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF

WASHINGTON | GOVERNMENT PRINTING OFFICE | 1926

INDEX

	Page
Petition	1
Writ of Certiorari Applied for by Respondent	1
Questions presented:	
(1) Do the laws of the State of New York require life insurance companies to maintain any reserves other than reserves for unearned premiums	2
(2) Are net additions required to be made within the year to reserve funds by the Superintendent of Insurance of the State of New York to cover liabilities of a life insurance company arising from (*a*) special benefit disability contracts, (*b*) unreported death loss claims, (*c*) annuity contracts with respondent's agent, "reserve funds required by law" within the meaning of Section II G (b) of the Revenue Act of 1913	2
Statement	2
Reasons for granting the petition	3
Brief in support of petition	5
Opinions of the courts below	5
Judisdiction	5
Statement of facts	5
Statutes involved	7
Specification of errors to be urged	8
Argument:	
I. In the case of life insurance companies the only reserve required by the laws of the State of New York is the unearned premium reserve	10
II. The instant case is controlled by *McCoach* v. *Insurance Company of North America*, 244 U. S. 585	12
III. The case of *Maryland Casualty Company* v. *United States*, 251 U. S. 342, does not control this case	15
IV. Sums set aside to cover the liability arising from (*a*) special benefit disability contracts, (*b*) unreported loss claims, (*c*) annuity contracts with agents of the respondent are not "reserve funds required by law" within the meaning of Section II G (b) of the Revenue Act of 1913	16
(*a*)	16
(*b*)	17
(*c*)	18
Conclusion	20

AUTHORITIES CITED

Cases:

Page

McCoach v. *Insurance Company of North America*, 244 U. S. 585 ..... 4, 8, 12, 13, 14–15, 16, 18

Maryland Casualty Company v. *United States*, 251, U. S. 342 ..... 10, 15, 16, 19

United States v. *Boston Insurance Company*, No. 29 Sup. Ct., October Term, 1925 ..... 16, 17

Statutes:

Federal—

Section 242 (a) Judicial Code, as Amended by the Act of February 13, 1925 (43 Stat. 936, ch. 229) 5

Corporation Excise Tax Law of August 5, 1909, ch. 6, Section 38 (36 Stat. 11, 112–113) 12, 15

Revenue Act of October 3, 1913, ch. 16 (38 Stat. 172, 173) 5, 7–8, 15

State—

New York—

Insurance Law, Sections 39, 43, 44, 45 (27 McKinney's Consolidated Laws of New York, 56, 60–62) 12, 13

Insurance Law, Section 84 (27 McKinney's Consolidated Laws of New York 123) 11

Insurance Law, Section 86 (1) (27 McKinney's Consolidated Laws of New York 126) 11

Insurance Law, Section 86 (2) (27 McKinney's Consolidated Laws of New York 127) 16

Insurance Law, Section 118 (27 McKinney's Consolidated Laws of New York 215) 17

Pennsylvania:

Act of June 1, 1911, P. L. 607, Section 8 15

Act of June 1, 1911, P. L. 607, Sections 4 & 15 13

Miscellaneous:

Eldridge's Principles of Reservation in their application to Legislative Regulation of Life Insurance—p. 9 10

Yale Readings in Insurance—Fire—p. 23 10

Yale Readings in Insurance—Life (Revised Edition)—pp. 209, 210 10

In the Supreme Court of the United States

OCTOBER TERM, 1925

No. ——

WILLIAM H. EDWARDS, AS COLLECTOR OF INTERNAL REVENUE for the Second District of New York, Petitioner

v.

NEW YORK LIFE INSURANCE COMPANY

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of William H. Edwards, as Collector of Internal Revenue for the Second District of New York, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in the above case on August 6, 1925, in so far as said judgment is adverse to your petitioner.

WRIT OF CERTIORARI APPLIED FOR BY RESPONDENT

This Court on October 26, 1925, granted an application made by respondent for a writ of certiorari on two questions decided adversely to it by said Circuit Court of Appeals, and petitioner, conceding

that the questions sought to be reviewed by respondent are of a far-reaching public importance, respectfully represents to the Court that there is still another question in this case, which is not sought to be reviewed by respondent because decided in its favor in the court below, but which is of equally far-reaching public importance. That question is, whether any reserves other than unearned premium reserves within the meaning of the Revenue Act of October 3, 1913, and under the laws of the State of New York, are required by law in the case of life insurance companies.

The answer to this question depends upon the determination of the following questions:

QUESTIONS PRESENTED

(1) *Do the laws of the State of New York require life insurance companies to maintain any reserves other than reserves for unearned premiums?*

(2) *Are net additions required to be made within the year to reserve funds by the Superintendent of Insurance of the State of New York to cover liabilities of a life insurance company arising from—*

(*a*) *Special benefit disability contracts,*

(*b*) *Unreported death loss claims,*

(*c*) *Annuity contracts with respondent's agents, "reserve funds required by law" within the meaning of Section II G (b) of the Revenue Act of 1913?*

STATEMENT

Respondent brought suit in the District Court of the United States for the Southern District of

New York to recover, among other items, the sum of $4,272.70, additional taxes assessed against it by the Commissioner of Internal Revenue for the calendar year 1913, growing out of the disallowance by the said Commissioner of certain deductions made by respondent from its gross income on account of net additions to certain of its "reserves" alleged to have been "required by law."

The Government contends that the only "reserves required by law" in the case of life insurance companies, within the meaning of the Revenue Act of October 3, 1913, and the laws of the State of New York, are the unearned premium reserves; whereas respondent contends that by law it was required to maintain the "reserves" in controversy and was therefore entitled to deduct from its gross income for the year 1913 the net additions to such reserves made in the year 1913 under the authority of said Act of Congress.

The District Court sustained the position of the respondent and rendered judgment in its favor, which judgment was affirmed by the Circuit Court of Appeals for the Second Circuit.

For the language of the statutes involved and a more detailed statement of the facts, reference is made to the supporting brief included herein.

REASONS FOR GRANTING THE PETITION

1. The Circuit Court of Appeals has misconstrued the meaning of the words "reserve funds

required by law" as used in Section II G (b) of the Revenue Act of 1913.

2. The decision of the Circuit Court of Appeals is not in harmony with the decision of this Court in the case of *McCoach* v. *Insurance Company of North America*, 244 U. S. 585.

3. The question as to what reserves are required by law in the case of life insurance companies is one of great public interest and of great importance to the Government in the administration of the revenue laws. It affects every life insurance company in the United States, and there are a large number of suits now pending in the courts involving the question. A final decision by this Court will establish a rule for the settlement of all these cases.

4. The amount involved in this and many similar cases now pending in the courts and before the Treasury Department is approximately $500,000.

Wherefore, it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Second Circuit, in so far as the same is adverse to your petitioner, should be granted.

WILLIAM D. MITCHELL,
Solicitor General.

NOVEMBER, 1925.

BRIEF IN SUPPORT OF PETITION

OPINIONS OF THE COURTS BELOW

The opinion of the United States District Court is reported in 3 Fed. (2d), page 280, and is to be found in the record at page 126.

The opinion of the Circuit Court of Appeals for the Second Circuit is not officially reported as yet, but will be found at page 156 of the record.

JURISDICTION

The judgment of the District Court was entered December 15, 1924 (R. 22), and that of the Circuit Court of Appeals on August 6, 1925 (R. 177).

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925 (43 Stat. 936, ch. 229).

STATEMENT OF FACTS

Respondent is a mutual life insurance corporation existing under the laws of New York.

Its policies are all issued on the mutual level premium plan and it transacts business throughout the United States and in many foreign countries. (R. 25–26.)

In making its return for the calendar year 1913 under the provisions of Section II, Subdivision G (a) and (b), of the Revenue Act of October 3, 1913, respondent deducted from its gross income as "net additions required by law to be made within the year to reserve funds"—

(*a*) The sum of $16,629 to meet the losses of future premiums under certain of its policies providing for the waiving of such premiums if the insured should become totally and permanently disabled. (R. 53.)

(*b*) The sum of $250,000 to meet respondent's liabilities on unreported death losses for the year 1913. (R. 55–56.)

(*c*) The sum of $160,641 to meet respondent's liabilities on contracts of employment with its agents, under which after twenty years continuous service and the accomplishment of certain prescribed minimum results each such agent becomes entitled to an income for life, payable monthly, the amount of the payment being based upon the results obtained by each such agent during the twenty-year period. (R. 56.)

The respondent in its annual report to the Commissioner of Insurance of the State of New York for the year ending December 31, 1913, on blank forms prescribed by the Insurance Department of said State, under the heading "liabilities, surplus and other funds," set up the foregoing items as follows (R. 64):

Item 9a. Increase in present value of future premiums waived on account of total and permanent disability	$16,629
Item 14. Increase in reserve for net death losses incurred but unreported	250,000
Item 43. Increase of reserve for Nylic contracts	151,641 (160,641?)

The Commissioner of Internal Revenue on reaudit of respondent's return for the calendar year 1913

disallowed the above items as deductions, restored the same to gross income, and assessed and collected under protest additional taxes on account thereof as follows (R. 39):

$166.29 on said item of $16,629.
$2,500 on said item of $250,000
$1,606.41 on said item of $160,641.

Respondent's claim for refund of these items, as well as others, having been rejected (R. 37–38), suit for recovery was brought in the United States District Court for the Southern District of New York, resulting in the entry of judgment on these items in favor of respondent (R. 22–23), and this judgment, on writ of error, was affirmed by the Circuit Court of Appeals for the Second Circuit (R. 177).

STATUTES INVOLVED

The pertinent portions of the Act of Congress approved October 3, 1913, applicable to this case are to be found in Section II, Subdivision G (a) and (b) (38 Stat. 172, 173, ch. 16), reading as follows:

> That the normal tax hereinbefore imposed upon individuals likewise shall be levied, assessed, and paid annually upon the entire net income arising or accruing from all sources during the preceding calendar year to * * * every insurance company, organized in the United States, no matter how created or organized, not including partnerships; * * *
>
> Such net income shall be ascertained by deducting from the gross amount of the in-

> come of such * * * insurance company, received within the year from all sources, (first) all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any; * * * *and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts.* * * * [Italics ours.]

SPECIFICATION OF ERRORS TO BE URGED

The errors which petitioner urges as grounds for the granting of the writ of certiorari and for the reversal of the decision of the Circuit Court of Appeals for the Second Circuit are:

1. The court erred in holding with the District Court that any reserve of a life insurance company under the laws of the State of New York other than the unearned premium reserve is a reserve required by law within the meaning of the Revenue Act of October 3, 1913;

2. The court erred in not following the principles heretofore laid down by this Court in *McCoach*

v. *Insurance Company of North America*, 244 U. S. 585;

3. The court erred in holding that the item of $16,629, representing the value as of December 31, 1913, of future premiums waived on account of total and permanent disability contracts, was a net addition to reserves required by law and constituted an allowable deduction from respondent's income for the year 1913 under the provisions of the Revenue Act of October 3, 1913;

4. The court erred in holding that the item of $250,000, representing liabilities upon losses which had occurred but which had not yet been reported, was a net addition to reserves required by law and constituted an allowable deduction from respondent's income for the year 1913 under the provisions of the Revenue Act of October 3, 1913;

5. The court erred in holding that the item of $160,641, representing liabilities of respondent's contracts of employment with certain of its soliciting agents providing for the payment under certain prescribed conditions to each such agent of an income for life, payable monthly, was a net addition to reserves required by law and constituted an allowable deduction from respondent's income for the year 1913 under the provisions of the Revenue Act of October 3, 1913.

ARGUMENT

I

In the case of life insurance companies the only reserve required by the laws of the State of New York is the unearned premium reserve

This Court has said in *Maryland Casualty Company* v. *United States*, 251 U. S. 342, 350, that—

> the term "reserve" or "reserves" has a special meaning in the law of insurance.

In connection with fire insurance the term has been applied since the year 1837 to the unearned premium fund. (Yale Readings in Insurance, Fire, p. 23.) In connection with life insurance it is usually called the "net value" of the policy. (Eldrige's Principles of Reservation in their Application to Legislative Regulation of Life Insurance, p. 9.)

The reserve of a life insurance company has further been defined in Yale Readings in Insurance, Life (Revised Edition), pp. 209–210, as follows:

> The laws of the several states prescribe the maximum rate of interest that may be assumed, and the mortality table that shall be used, in computing the reserve or net value of a company's policies. This requirement is termed the *legal standard of valuation*. The net value computed by the *legal standard* is termed the *legal net value* or *legal reserve*.

The laws of New York contain specific provisions for estimating the legal reserves for the different classes of insurance, and the required reserves are materially different for life, health, casualty, fire, and other insurance companies.

Article II of the New York Insurance Law, Consolidated Laws, ch. 28, by Section 86 (1) (27 McKinney's Consolidated Laws of New York 126), specifically provides that in estimating the condition of a life insurance corporation the Superintendent of Insurance—

> shall charge as liabilities, in addition to the capital stock, all outstanding indebtedness of the corporation, and *the premium reserve on policies, and additions thereto in force computed according to the table of mortality and rate of interest prescribed in this article.* [Italics ours.]

Thus the only reserve for which specific provision is made is "the premium reserve on policies, and additions thereto in force," and a preceding section (Section 84) prescribes in detail the method of "valuation" of life insurance policies and how the Superintendent of Insurance shall determine said "premium reserve."

Nowhere does it appear that the Superintendent of Insurance is given power by statute to require any reserve other than the "premium reserve on policies" in the case of life insurance companies.

It does appear that the Superintendent of Insurance is given the power to examine such insur-

ance companies and they are required to submit to him annual reports upon forms prescribed by him. Upon his discovery that "the assets * * * of any mutual insurance corporation are insufficient to justify its continuance in business," he is given power to determine the deficiency and require the same to be made good, failing which "the corporation shall be deemed insolvent." (See Sections 39, 43, 44, and 45, New York Insurance Law, Consolidated Laws, ch. 28; 27 McKinney's Consolidated Laws of New York, 56, 60–62.) It is evident that the purpose of these provisions is to enable the Superintendent of Insurance to ascertain the solvency or insolvency of insurance corporations doing business in the State of New York.

The fact, however, that the Superintendent of Insurance designates as reserves, on forms prescribed and furnished by him for annual reports, the outstanding itemized indebtedness of a life insurance company, cannot constitute the separate items of such "outstanding indebtedness" "reserves required by law" within the meaning of the Act of Congress approved October 3, 1913. *McCoach* v. *Insurance Company of North America*, 244 U. S. 585, 589.

II

The instant case is controlled by McCoach v. Insurance Company of North America, 244 U. S. 585

In that case, which arose under the Act of Congress approved August 5, 1909, ch. 6, Sec. 38 (36

Stat. 11, 112–113), as in this, the question under consideration was the deduction from gross income of "the net additions, if any, required by law to be made within the year to reserve funds." That case involved a Pennsylvania fire insurance company—this a New York life insurance company.

The powers and duties of the respective superintendents of insurance of Pennsylvania and New York are in all essentials practically identical. The superintendent of each State is required to see that the laws of his State are faithfully executed with respect to insurance companies. He is empowered to make examinations; to have access to all the books, papers, etc., of any company; to suspend the business of any company violating the laws; and each company is required to file annual statements upon blanks furnished by him such as shall seem to him best adapted to elicit a true exhibit of its financial condition. (Laws of Pennsylvania, Act of June 1, 1911, P. L. 607, Sections 4 and 15; New York Insurance Law, Consolidated Laws, ch. 28, Sections 39, 43, 44, 45; 27 McKinney's Consolidated Laws of New York 56, 60–62.)

The laws of Pennsylvania, considered in the *McCoach* case, specifically required of fire insurance companies only a "reserve for reinsurance." The Superintendent of Insurance, however, required the company, and all similar companies, to reserve each year, as an item among other liabilities, the amount of "unpaid losses," whether actually adjusted, in process of adjustment, or

resisted. That practice was relied upon as an administrative interpretation of the law.

The Court in disposing of the case said (244 U. S. 589):

> Conceding full effect to this, it still does not answer the question whether the amounts required to be held against unpaid losses, in the case of fire and marine insurance companies, are held as "reserves," within the meaning of the Pennsylvania law or of the act of Congress, however they may be designated upon the official forms. As already appears, the Pennsylvania act specifically requires debts and claims of all kinds to be included in the statement of liabilities, and treats them as something distinct from reserves. The object is to exercise abundant caution to maintain the companies in a secure financial position.
>
> The act of Congress, on the other hand, deals with reserves not particularly in their bearing upon the solvency of the company, but as they aid in determining what part of the gross income ought to be treated as net income for purposes of taxation. *There is a specific provision for deducting "all losses actually sustained within the year and not compensated by insurance or otherwise." And this is a sufficient indication that losses in immediate contemplation, but not as yet actually sustained, were not intended to be treated as part of the reserve funds; that term rather having reference to the funds*

ordinarily held as against the contingent liability on outstanding policies.

In our opinion the reserve against unpaid losses is not " required by law," in Pennsylvania, within the meaning of the act of Congress. [Italics ours.]

This language appears decisive of the issue here in controversy.

III

The case of Maryland Casualty Company v. United States, 251 U. S. 342, does not control this case

This was also a case arising under the laws of the State of Pennsylvania and was an appeal from the Court of Claims. It was a suit to recover taxes under the Corporation Excise Tax Act of 1909, and the Income Tax Act of October 3, 1913, ch. 16, 38 Stat. 114, 166, 172, 173, and involved, among other things, certain claimed deductions from gross income of the " net addition, if any, required by law to be made within the year to reserve funds."

The Maryland Casualty Company was a *casualty* insurance company and not a life or fire insurance company, and the loss claims reserve of a casualty company was deductible from gross income because it was in fact a reserve specifically required by the laws of the State of Pennsylvania. (Act of June 1, 1911, P. L. 607, Sec. 8.)

A like reserve in the case of casualty insurance companies is required by the statutes of the State

of New York. (New York Insurance Law, Consolidated Laws, ch. 28, Section 86 (2) (b); 27 McKinney's Consolidated Laws of New York 127.)

When the difference in the laws respecting the "reserves" required of life and fire insurance companies on the one hand and of casualty insurance companies on the other is considered, there is no inconsistency between the *McCoach* case and the *Maryland Casualty Company* case; nor is there anything said in the latter case to indicate that this Court intended to overrule or question the authority of the *McCoach* case.

Because of the apparent conflict between the *McCoach* case and the *Maryland Casualty Company* case the question as to whether the loss claims reserve of a New York fire insurance company is a "reserve required by law" is now before this Court in the case of *United States* v. *Boston Insurance Company* (October Term, 1925, No. 29), recently argued and submitted, and the decision of this Court in that case will undoubtedly in principle control the instant case.

IV

Sums set aside to cover the liability arising from (a) special benefit disability contracts, (b) unreported loss claims, (c) annuity contracts with agents of the respondent are not "reserve funds required by law" within the meaning of section II G (b) of the Revenue Act of 1913

(*a*) The first item above represents the value as of 1913 of premiums which under the special benefit disability provisions of certain of its policies

respondent agreed to pay for the account of certain of its policyholders who had become disabled. The fund represents the present value of future payments *to be paid by respondent to itself* on behalf of those policyholders who have incurred permanent disability. Theoretically, respondent should show on its records a payment of an amount equal to said premiums. Moreover, it is a fund maintained for the payment of *incurred* claims and is deductible only when actual payment is made. Since, however, the payment is made to itself, the premium would be included in gross income and would offset the deduction. As has been shown (ante p. 6), this item was reported as a liability. It was, however, not a "reserve required by law" within the meaning of the Revenue Act of October 3, 1913.

(*b*) The "loss claim reserve" involved in the second item so far as the question affects a New York fire insurance company is again before this Court, as above indicated, in *United States* v. *Boston Insurance Company, supra.*

Section 118 of the New York Insurance Law, Consolidated Laws, ch. 28 (27 McKinney's Consolidated Laws of New York 215), provides that in estimating the liabilities of a fire insurance company "there shall be charged in addition to the capital stock and all outstanding claims, *a sum equal to the total unearned premiums on the policies in force,* calculated on the gross sum without any deduction on any account, charged to

policyholder on each respective risk from the date of the issue of the policy." (Italics ours.)

It seems apparent, therefore, that the requirements of the laws of the State of New York, in so far as reserves of life and fire insurance companies are concerned, are practically identical and that the object of the law is to elicit a statement of the true financial condition of the company.

As this Court said in the *McCoach* case, *supra*, (page 589):

> As already appears, the Pennsylvania act specifically requires debts and claims of all kinds to be included in the statement of liabilities, and treats them as something distinct from reserves. *The object is to exercise abundant caution to maintain the companies in a secure financial position.*
>
> The act of Congress, on the other hand, deals with reserves *not particularly in their bearing upon the solvency of the company*, but as they aid in determining what part of the gross income ought to be treated as net income for purposes of taxation. [Italics ours.]

The unreported loss claims reserve of a life insurance company under the statutes of the State of New York is not a true "reserve" as that word is used in the taxing statute.

(*c*) The reserves set up by respondent to meet its liabilities on its annuity contracts with its soliciting agents are not true insurance "reserves" within the purview of the Act of Congress. Al-

though the liabilities which the funds secured are contract obligations, they nevertheless arise out of employment contracts and are clearly in the nature of a pension or additional compensation to faithful employees for services rendered and not insurance contracts.

They are clearly in the nature of a business expense *when paid,* and while a business expense when paid is a proper deduction, a so-called "reserve" to take care of business expenses or pensions to employees is clearly not a "reserve" as that term is used in the taxing statute.

As was said by this court in the *Maryland Casualty Company* case, *supra* (page 350):

> The requirements relied upon, of the Insurance departments of New York, Pennsylvania and Wisconsin that "assets as reserves" must be maintained to cover "all claims," "all indebtedness," "all outstanding liabilities," in terms might include the rejected items we are considering, but plainly the departments, in these expressions used the word "reserves" in a non-technical sense as equivalent to "assets," as is illustrated by the Massachusetts requirement that each company shall "hold or reserve assets" for the payment of all claims and obligations. The distinction between the "reserve" and general assets of a company is obvious and familiar and runs through the statements of claimant and every other insurance company. That provision for the payment of ordinary expenses

such as we are considering was not intended to be provided for and included in "reserve funds" as the term is used in the acts of Congress is plain from the fact that the acts permit deductions for such charges from income if paid within the year, and the claimant was permitted in this case to deduct large sums for such ordinary expenses of the business—specifically, large sums for taxes.

CONCLUSION

Because of the great importance of the question here involved in the practical administration of the revenue laws, it is respectfully submitted that the petition for a writ of certiorari should be granted.

WILLIAM D. MITCHELL,
Solicitor General.

MABEL WALKER WILLEBRANDT,
Assistant Attorney General.

NOVEMBER, 1925.

○